G-008/C-91-942 ORDER APPROVING COST ALLOCATION METHODS AND LEAK SURVEY PLAN WITH MODIFICATIONS, REQUIRING REPORT, FINDING VALUE IN GOOD WILL, AND DEFERRING VALUATION TO RATE CASE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Marshall Johnson	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner

In the Matter of the Complaint of the Minnesota Alliance for Fair Competition Against Minnegasco, a Division of Arkla, Inc.

ISSUE DATE: March 24, 1994

DOCKET NO. G-008/C-91-942

ORDER APPROVING COST ALLOCATION METHODS AND LEAK SURVEY PLAN WITH MODIFICATIONS, REQUIRING REPORT, FINDING VALUE IN GOOD WILL, AND DEFERRING VALUATION TO RATE CASE

PROCEDURAL HISTORY

I. INITIAL PROCEEDINGS

On November 27, 1991, the Minnesota Alliance for Fair Competition (MAC), a trade organization of plumbing, electrical and appliance associations, filed a complaint against Minnegasco, a division of Arkla, Inc. (Minnegasco or the Company). The complaint alleged that Minnegasco subsidizes its nonregulated appliance sales and service operations through its regulated utility operations, offers preferential treatment to ratepayers who use its appliance sales and service operations, and uses its appliance inspection service to manipulate ratepayers into purchasing appliances from Minnegasco.

On January 29, 1992, the Commission issued its ORDER SEVERING MINNEGASCO FROM THE INVESTIGATION DOCKET, GRANTING DISCOVERY RIGHTS, REQUIRING REPORT AND AUTHORIZING COMMENTS. In that Order the Commission removed Minnegasco from an ongoing generic investigation of utility appliance sales and service operations and established the current complaint proceeding. The Commission also granted MAC discovery rights and required the association to file a report on its investigation.

On November 10, 1992, the Commission issued its ORDER ESTABLISHING ACCOUNTING PROCEDURES AND REQUIRING FURTHER FILINGS. Although the Commission found no pattern of preferential treatment or fraudulent practice on the part of Minnegasco, the Commission determined that the Company needed "to replace existing ad hoc allocation procedures with a cohesive and comprehensive approach to cost separations." Order at p. 4. The Commission ordered Minnegasco to adopt cost separation principles developed by the Federal Communications Commission (FCC). The Order also required the Company to charge the cost of carbon monoxide (CO) checks to nonregulated operations and to submit filings regarding its winter residential gas leak detection program and various allocation issues.

On February 8, 1993, the Commission issued its ORDER AFTER RECONSIDERATION CLARIFYING EARLIER ORDER. In that Order the Commission stated that its November 10, 1992 finding of no pattern of preferential treatment was limited to the Company's gas installation scheduling practices.

On April 22, 1993, Minnegasco's compliance filings, and the other parties' comments on them, came before the Commission. MAC contended that Minnegasco had failed to implement FCC allocations properly and that its regulated operations continued to subsidize its appliance sales and service operations. The Department of Public Service (the Department) recommended that the Commission initiate contested case proceedings. The Residential Utilities Division of the Office of Attorney General (RUD-OAG) and the Company concurred.

On May 5, 1993, the Commission issued its NOTICE AND ORDER FOR HEARING. The Commission referred the case to the Office of Administrative Hearings, which assigned Administrative Law Judge (ALJ) Richard C. Luis to hear the matter.

On May 26, 1993, the ALJ convened a prehearing conference. On June 28, 1993, the ALJ issued a Prehearing Order setting forth the schedule of the proceedings and the order of filings. The schedule was later amended.

II. MOTIONS CERTIFIED TO THE COMMISSION

On August 4, 1993, Judge Luis certified to the Commission portions of two motions to compel discovery brought against Minnegasco by MAC. These issues were later resolved by the parties in a stipulation. The ALJ also certified the question of limiting consideration of allocation methodologies and accounting practices to those used by the Company since July 1, 1993.

On September 20, 1993, the Commission issued its ORDER DETERMINING CERTIFIED ISSUES AND AFFIRMING DECISION OF ADMINISTRATIVE LAW JUDGE. In that Order the Commission agreed with the ALJ that a full examination of the issues requires a frame of reference and historical context which is more comprehensive than post-July 1 data alone can provide. The Commission therefore found that the proceedings should not be limited to consideration of post-July 1, 1993 data.

On October 7, 1993, the Commission issued its ORDER AFFIRMING DECISION CERTIFIED BY ADMINISTRATIVE LAW JUDGE. In that Order the Commission affirmed the ALJ's decisions on MAC's discovery requests. The Commission allowed MAC discovery of Minnegasco's apportionment methods, but denied discovery of Arkla's allocations to its various divisions.

III. PARTIES AND REPRESENTATIVES

Minnegasco was represented in these proceedings by Paul T. Ruxin, Jones, Day, Reavis & Pogue, North Point, 901 Lakeside Avenue, Cleveland, Ohio, 44114, and by Brenda A. Bjorklund and Miggie E. Cramblit, Minnegasco, 201 South 7th Street, Minneapolis, Minnesota 55402.

The Department of Public Service was represented by Scott Wilensky, Special Assistant Attorney General, 1200 NCL Tower, 445 Minnesota Street, St. Paul, Minnesota 55101-2130.

The Minnesota Alliance for Fair Competition was represented by James Larson, Wurst, Pearson, Larson, Underwood & Mertz, 1100 One Financial Plaza, Minneapolis, Minnesota 55401.

The Residential Utilities Division of the Office of the Attorney General was a party but did not appear at the evidentiary hearings or Commission meetings, or file testimony or briefs.

IV. EVIDENTIARY HEARINGS

Evidentiary hearings were held by Judge Luis from October 28 through November 3, 1993. The ALJ filed his report on January 6, 1994.

V. PROCEEDINGS BEFORE THE COMMISSION

The matter came before the Commission for consideration on February 23 and 24, 1994.

FINDINGS AND CONCLUSIONS

I. INTRODUCTION

In these proceedings MAC consistently argued that Minnegasco's appliance sales and service operations must be completely separated from the core business in order to prevent unfair subsidization of the nonregulated enterprise by the regulated entity.

The Department and the ALJ agreed that combined operations can be appropriate and even beneficial if the Company's fully allocated cost methods are improved and properly applied.

The Department expressed concerns regarding the auditability, appropriateness, and internal controls of certain of the Company's allocation methods. The ALJ found that the concerns raised by the Department are legitimate and that the Company must continue to monitor and improve its methods in order to answer those concerns.

The ALJ agreed with changes to the Winter Residential Leak Survey system recommended by the Department and implemented by the Company.

In their briefs and MAC's testimony the Company and MAC discussed the possibility of good will value flowing to the nonregulated entity from the regulated utility.

II. STRUCTURE OF THE REGULATED AND NONREGULATED ENTERPRISES

A. Background

In its appearances before the ALJ and the Commission MAC argued the necessity of structurally separating Minnegasco from its nonregulated appliance enterprise. According to MAC, the basic fact that Minnegasco, a regulated utility, has a nonregulated appliance sales and service division creates an incentive for subsidization. MAC stated that the Company did improperly subsidize its nonregulated affiliate.

MAC argued that Minnegasco's application of FCC fully allocated cost methodologies (embodied since 1993 in its cost apportionment manual, or CAM) was unproven and therefore an insufficient guard against cross-subsidization. MAC argued further that structural separation of the regulated and nonregulated entities would eliminate the need for any CAM, task force on methodologies, or monitoring of Company methods.

The Commission first made a finding that structural separation was not necessary in the November 10, 1992 Order. At p. 9 of that Order the Commission stated: "While the Company's cost allocation procedures require improvement, they do not justify the punitive action [i.e. structural separation] MAC recommends."

In his report following contested case proceedings, the ALJ agreed with the Department's opinion that structural separation was not necessary. After careful consideration the ALJ found that MAC's allegations of Minnegasco cross-subsidization in 1991 and 1992 were refuted in the record. Since that time, Minnegasco adopted FCC fully allocated cost apportionment in its CAM. The ALJ found that Minnegasco's use of its CAM, if improved and carefully monitored, would prevent cross-subsidization and allow mutual benefits.

B. Commission Action

The Commission agrees that the full record developed in the contested case proceedings supports the Commission's initial finding in the November 10, 1992 Order. The fact that Minnegasco has linked regulated and nonregulated entities does not create a presumption of impropriety or cross-subsidization. The Commission notes that the affiliated interest statute, Minn. Stat. § 216B.48, was enacted to monitor such linked regulated and nonregulated entities. Neither does the record show a pattern of subsidization, fraud, or abuse.

The Commission did find in the November 10, 1992 Order that there were imperfections in the Company's allocation methods which could be alleviated by adoption of FCC principles. Even at that time, however, the Commission stated that the Company's current methods were not fatally flawed: "While a fully allocated cost approach is more appropriate in this context, the Company was not outside the bounds of defensible business practice in using the approach it used." Order at p. 9.

Now, the Company has complied with the Commission's directive and adopted the FCC principles in its CAM. The fact that the CAM is new does not persuade the Commission that it is therefore an ineffective tool against cross-subsidization. Neither does the fact that allocations will necessarily change with the use of the CAM show that allocations under pre-CAM methods resulted in cross-subsidization. As the ALJ stated at p. 13 of his report: "More importantly, the change in methodology necessarily produced a change in reported results. This is not evidence of a subsidy, only of a change in methodology."

The Commission finds that the Company's fully allocated cost methodologies, with continued improvements, monitoring and protections discussed more fully below, will provide fair apportionment between the Company's regulated and nonregulated enterprises. The Commission will not require structural separation of the Company's regulated utility and nonregulated appliance operation.

III. ALLOCATIONS UNDER THE COMPANY'S METHODOLOGY

A. Introduction

Minnegasco requested that the Commission approve its overall allocation system.

MAC stated that the Company's allocation system was untested and unproven and was inadequate to protect against cross-subsidization.

The Department stated that the Company's cost allocation and accounting system has improved, seems auditable, but needs further revisions. The Department questioned inaccuracies in reporting of Winter Residential Leak Surveys, miscoding of expenses, and the system of reporting employee exception time.[1]

In addition, the Department had problems with certain specific Minnegasco cost allocations and recommended modifications in ten categories. The ALJ for the most part agreed with the Department's recommendations. The Company filed exceptions to certain of the ALJ findings; five allocation issues remained contested as the matter came before the Commission.

The Commission agrees with the Department that the Company's reporting of employee exception time remains unclear. The Commission will require the Company to file an explanation of its exception time reporting.

The Commission agrees with and adopts each of the ALJ's findings regarding cost allocations, with the exception of the Costs for Investigation category. The most important findings will be detailed following in this Order. Other findings, which the Commission also adopts, are found in pp. 17-32 of the ALJ's report, attached to and made a part of this Order as Attachment A.

[1] Exception time is employee time spent performing unusual or out of the ordinary tasks.

B. Contested Allocations

1. Billing Costs

Minnegasco proposed using the contents and size of billing envelopes to allocate billing costs between the regulated and nonregulated entities. MAC advocated using the numbers of customers in each entity. The Department and the ALJ recommended apportioning regulated-only billing costs to the regulated side, nonregulated-only costs to the nonregulated, and splitting combined billings 50%/50%.

The Commission finds that the Department's and ALJ's recommendation regarding billing costs is the most appropriate. The mailing function, not envelope size, is the chief cause of billing costs. When a mailing has combined regulated and nonregulated functions, its cost should be shared equally by regulated and nonregulated entities.

2. Material Handling

Minnegasco proposed allocating material handling costs by using a ratio of regulated and nonregulated dollar values of parts and materials issued to the total dollar value of parts and materials issued through Minnegasco's warehouse. The Department stated that dollar values were not sufficient; the Company must also use the number of charge-outs or issuances. The ALJ agreed with the Department.

The Commission finds that an allocation based on a combination of dollar values and charge-outs is the most appropriate because it is the method which best reflects cost causation. The Commission adopts the ALJ's finding on this issue.

3. Service Technicians/Gas Checks

Minnegasco proposed allocating 100% of these costs to the regulated entity. The Company argued that to do otherwise would discourage customers from calling for help in an emergency.

MAC advocated allocating the cost according to whether the gas leak is on utility-owned or customer-owned equipment. This is in accordance with FCC guidelines.

The Department recommended either splitting costs according to which phone line the emergency call was placed upon, or adopting MAC's position. The ALJ agreed with MAC's recommendation.

The Commission finds that the ALJ's recommendation, first suggested by MAC, is most appropriate. The cost of responding to a gas leak should be charged to the nonregulated business if the gas leak is on internal piping or associated with an appliance. If the cost arises from a leak on the utility system, the charge should be to the regulated entity. This allocation method is consistent with FCC precedent and principles of cost causation.

4. Accounts Payable

Minnegasco proposed using the general allocator to assign costs for this category.

The Department recommended allocating costs between regulated and nonregulated entities according to the number of regulated/nonregulated invoices, and splitting common invoices 50%/50%. The ALJ agreed with the Department.

The Commission adopts the finding of the ALJ for this category. This method best reflects cost causation by allocating wholly regulated costs to the utility, wholly nonregulated costs to the nonregulated entity, and the costs of processing combined invoices equally to the regulated and nonregulated operations.

5. Costs for Investigation

Minnegasco recommends using the general allocator[2] to determine the allocation of regulatory investigation costs to the regulated and nonregulated entities. The Company stated that this method is consistent with FCC principles. MAC maintained that the costs of investigation are directly caused by Minnegasco's engaging in its nonregulated appliance business; the costs should be allocated entirely to the nonregulated enterprise.

The Department stated that application of the general allocator ignores the causation of the costs. According to the Department, the costs should be split at a minimum 50%/50%. The ALJ generally agreed, stating: "This proceeding arose because of the Company's engagement in a nonregulated business, and the resultant costs should be assigned more heavily to those operations..."

The Commission finds that the general allocator is more appropriately applied in the case of a rate proceeding than in this case, which was initiated by a complaint regarding the Company's nonregulated enterprise. The regulatory costs of this investigation would not have arisen if Minnegasco had not made the past decision to add a nonregulated appliance sales and service business to its regulated enterprise. For this reason, the Commission will require the Company to allocate 100% of the regulatory investigation costs to the nonregulated entity.

C. Uncontested Allocations

Allocation methods for the following categories were recommended by the Company, adopted by the ALJ, and finally uncontested by the parties: Tax Department; Appliance Sales Employees; General Allocator; Delinquent Accounts Receivable; and Departmental Apportionment.

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[2] A general allocator is used to allocate costs which are not apportioned based upon either direct or indirect measures of cost causation. The general allocator is based upon the ratio of all expenses directly assigned or attributed to regulated and nonregulated operations.

IV. WINTER RESIDENTIAL LEAK SURVEYS

A. Background

Leaking gas from broken system pipes or fittings normally travels upward to the soil surface. In winter, however, a frost cap can block this normal pathway, forcing the gas to migrate to the point of lowest air pressure. The result can be a leak migrating into customers' homes or other buildings. Minnegasco's Winter Residential Leak Survey (WRLS) is a program whereby servicepersons conduct leak surveys any time they enter the home of a Minnegasco customer during the winter months.

In its May 5, 1993 NOTICE AND ORDER FOR HEARING, the Commission asked parties to address whether the Company's WRLS program is prudently designed and operated.

B. Positions of the Parties and ALJ

MAC responded that Minnegasco's program is neither prudently designed nor properly operated. According to MAC, the system shows an intrinsic preference for customers of the nonregulated entity and amounts to a subsidy of the nonregulated enterprise by the utility. MAC stated that Minnegasco had not proven the results or cost-effectiveness of the system. MAC pointed to the fact that there is only one other utility in the Midwest which is currently employing the same safety inspection system.

While Minnegasco maintained that its system was prudently designed and operated, the Company remained open to suggestions submitted by the Department. The Company incorporated the following recommendations of the Department: a minimum random sampling of 10% of each served community would be conducted, excluding multiple surveys of the same residence; repeat checks would be allowed, although not as part of the minimum 10%; the Company would make improvements to its bookkeeping and timekeeping; Minnegasco would record the actual time spent on the check, rather than a preset estimated time. In addition, Minnegasco proposed using all qualified utility employees to conduct the surveys, not just appliance repairpersons.

The ALJ found Minnegasco's WRLS, as modified in cooperation with the Department, to be a prudent and reasonable plan. The ALJ stated that the leak survey program is a legitimate utility function, prudently conducted upon entering a customer's home. The ALJ also found that the program was cost-effective.

C. Commission Action

The Commission agrees with the ALJ that Minnegasco's WRLS program, as modified, is a prudent plan, appropriately operated. The overall plan strikes a proper balance between safety concerns and ratepayer protection.

The fact that only one other gas utility has a similar program does not convince the Commission that the Minnegasco plan is a poor one. The Commission is aware that every gas utility is federally mandated to design and conduct its own safety inspection system. The plans are likely to be as unique as the unique operating characteristics of each utility.

The Department and Office of Pipeline Safety have analyzed the Minnegasco program and found it to be appropriate. The ALJ has found it to be cost-effective, well-designed, and prudent. The Commission will approve the plan, with two further requirements, a survey percentage cap and exclusion of repeat checks.

1. Survey Percentage Cap

The Commission will allow cost recovery for a maximum number of survey checks, consisting of 20% of the service lines in a given community per year. The survey cap will ensure that the regulated utility is not paying more for safety inspections than necessary. This is particularly appropriate because it is likely that survey incidences will increase as more customers join the ServicePlus program of the nonregulated business. Ratepayers should not be required to absorb ensuing higher costs, beyond a level which is adequate to promote safety. A maximum survey rate of 20% will strike the proper balance between consumer safety and ratepayer financial interests.

2. Repeat Checks

The Commission will not allow costs of conducting repeat checks (defined as multiple visits to one site on a single job ticket or job order) as part of the WRLS. The benefits of repeat checks are not clear at this time. Excluding recovery for repeat checks is consistent with the fact that they are not allowed as part of the minimum 10% survey coverage.

The Commission will be requiring substantial reporting on the WRLS by the Company. When more information is available to the Commission it is possible that a reevaluation of the policy on repeat checks may be in order.

V. WORK GROUP ON MINNEGASCO ACCOUNTING

During these proceedings numerous questions were raised regarding Minnegasco's allocations, accounting system, and internal controls. The Commission has found that Minnegasco's allocations methods are reasonable and that separation of the regulated and nonregulated entities is not necessary. At the same time, the Commission recognizes that the improvements to the Company's methods have still resulted in a complex and sometimes difficult system. It is quite possible that further improvements could result in a more comprehensible and more readily monitored system.

During these proceedings Minnegasco suggested that a work group be formed to look further into the Company's allocation methods. The Company suggested that the Department, Commission Staff and the Company could meet to analyze the Company's CAM and explore further simplifications and improvements. The Department expressed its willingness to join such an endeavor.

The Commission agrees with the Company and the Department that a work group could be a useful tool for analyzing the Company's allocation methods. The group could determine if further simplifications are necessary for the Company's system, and if the Company's internal controls are adequate. The group could also recommend reporting requirements to assist understanding of apportionment results. Any proposed modifications should comply with FCC principles and require sufficient detailed information to support Company management needs.

The Commission will require the Company and the Department to work with Commission Staff on the formation of a work group along these lines. The group will be required to submit a report of its recommendations on or before October 1, 1994.

VI. GOOD WILL

A. Background

Early in this complaint proceeding MAC asked the Commission to require the Company's nonregulated entity to pay the regulated utility a license fee for the use of the Minnegasco name. The RUD-OAG supported the request in the early stages of the proceeding, but stated that the record was inadequate at that time to calculate the license fee. The RUD-OAG did not submit further written or oral comments on the license fee request or any other issue.

In the November 10, 1992 Order, the Commission attempted to clarify and limit certain issues in the complaint proceeding. The Order was preliminary in nature because the complaint itself remained open.

In the November 10 Order the Commission required the Company to adopt FCC accounting principles as a means of improving its allocations between the regulated and nonregulated entities. The Commission treated MAC's request for a license fee in light of the new accounting requirements:

> The Commission believes that imposing the FCC separations principles will ensure proper allocations of costs between regulated and unregulated operations, eliminating any need to set a specific license fee for the use of the Minnegasco name.
> Order at p. 6.

Since the November 10, 1992 Order the Company has adopted FCC cost allocation principles, the ALJ has conducted contested case proceedings, and the Complaint has come back before the Commission for disposition. The Commission now has the opportunity to assess the issue of Minnegasco's name and related intangibles with the benefit of a full record and a history of implemented FCC cost methodologies. The Commission is now prepared to make a determination on issues raised regarding the valuation of Minnegasco's name and related intangibles.

B. Definition of the Term Good Will

Parties to this proceeding have used the terms "name," "good will," and "other intangibles" to express the concept of an enhanced, intangible value in the regulated utility.

Good will is a phrase often employed by other commissions and courts to capture the concept of intangible, enhanced value. While definitions of good will vary, the general definitive terms used are name, image, and reputation.[3] The words defining good will convey the notion of a utility's history and pattern of service, which have resulted in an enhanced image in the eyes of the public and higher earning power for the utility.[4]

For purposes of this proceeding, the Commission will use the term good will to convey the value of the utility's name, reputation, and image.

B. Positions of the Parties; the ALJ

1. MAC

MAC argued that Minnegasco ratepayers have the right to control or to be compensated for the value which they built into Minnegasco's name. According to MAC, the value was established through the ratepayers' granting Minnegasco a monopoly to provide natural gas service.

MAC noted that public utility commissions in other jurisdictions have recognized a value built by ratepayers in the name and reputation of utilities. MAC stated that several state commissions have ordered recognition of that value through royalty payments of 2% to 5% of the nonregulated entity's gross revenues.

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[3] See, for example, Re Southern California Edison Company, 90 PUR 4th 45 (1988).

[4] Re Central Illinois Public Service Company, 101 PUR 4th 193, 199 (1989).

MAC entered into the record the "East Metro Test Results and Spring Recommendations," a consultant's marketing report submitted to Minnegasco in May, 1992.[5] The report reflected attempts by Minnegasco to market its nonregulated appliance sales and repair business in an area outside its regulated gas service territory. The report compared results of marketing under the Minnegasco name and under another, unrelated name. The results showed that Minnegasco received almost three times more inquiries under the Minnegasco name than under the nonrelated name. The consultant concluded that the Company should use Minnegasco ServicePlus rather than the unrelated name in its efforts to enter the expansion markets.

According to MAC, the marketing report supports the proposition that Minnegasco's good will has value which flows to the Company's nonregulated entity.

MAC urged the Commission to determine that the Company's name has value, and to require Minnegasco to discontinue the use of its name for the nonregulated entity. In the alternative, the Commission should order Minnegasco to compensate its ratepayers for the value of the use of the Minnegasco name by the nonregulated entity. MAC suggested a valuation of $ 3 million, based upon the nonregulated operation's cash flow.

[5] Schedule 3 of Mac's Surrebuttal Testimony of Derick O. Dahlen.

2. Minnegasco

Minnegasco argued that its name, good will and other related intangibles are not ratepayer assets because they have not been paid for by ratepayers or put into rate base. Because there is no cost to ratepayers for name or good will, there can be no subsidy of the nonregulated entity nor transfer of value to it. The Company argued that utility rates are cost-based; there has not been any cost to ratepayers for the Company name and there should therefore be no consequence in rates.

Minnegasco noted that Minn. Stat. § 216B.16, subd. 8 (d) disallows rate recovery for advertising expenses "designed primarily to promote good will for the public utility or improve the utility's public image." Charitable deductions are limited to 50 percent recovery under Minn. Stat. § 216B.16, subd. 9. Minnegasco argued that these statutory provisions are evidence that the Company's name and good will are not ratepayer-supported, but are rather shareholder responsibilities and assets.

The Company pointed out that it is not denying that its name and good will have value. The value is simply not paid for by ratepayers and clearly belongs to Company shareholders.

Finally, the Company stated that if the Commission did move in the direction of finding a ratepayer interest in the Company's name and good will, the matter should be developed in the context of a rate case.

3. The Department

The Department did not address the issue of good will in its filings. At the Commission meetings the Department indicated that it did not dispute the Commission's preliminary finding in the November 10, 1992 Order, but welcomed further clarification of this matter.

4. The ALJ

The ALJ agreed with Minnegasco that there can be no subsidy from the value of good will or other intangibles because they have imposed no cost on utility customers. They are not recorded as assets on Minnegasco's books and are not included in rate base. They are the property of the Company's shareholders, not ratepayers.

The ALJ found that "MAC's arguments regarding the use of intangible assets are inappropriate and do not establish an improper subsidy."

D. Commission Action

1. The Changing Nature of Utilities

Minnegasco's arguments regarding the value of good will are logical in the context of the classic monopoly situation. When competition is nonexistent and service can only be obtained from the monopoly utility, there is little benefit in promoting the utility's name. If a utility is "the only game in town," expenditures to promote its name cannot be said to create an asset.

Past Commission decisions and utility case law have followed this line of reasoning. As the Company noted, Minn. Stat. §§ 216B.16, subds. 8 (d) and (9) also reflect this view of the classic monopoly situation.

Since at least the 1970's, however, utilities have been moving away from the classic monopoly mode and toward greater diversification and competition. The Minnesota utility affiliated interest statute, enacted in 1974, reflects this trend in utility structure. The Commission's decisions have also demonstrated the move toward utility diversification and competition.

The issue of value for Minnegasco in its good will can no longer be determined by the principles of classic monopoly structure. The Commission must reassess this issue in light of the new utility realities.

2. Treatment of Good Will in Other Jurisdictions

The issue of good will has been considered by a number of state utility commissions in the 1990's, resulting in a split in jurisdictions. In California, for instance, the public service commission declared that a value cannot be imputed for utility good will. In so finding, the commission relied upon the classic precept that there is no value to good will in monopoly situations. On the other hand, commissions in New York, Florida and Oklahoma have imputed royalty revenues for good will.

In a recent New York decision, Re Rochester Telephone Corp., 145 PUR 4th 419 (1993), the New York Public Service Commission (NYPSC) imputed a 2% royalty adjustment to the revenues of Rochester Telephone Corporation (Rochester) as compensation for the transfer of intangible assets to nonregulated subsidiaries. The order also established a generic policy of imputing a 2% royalty for ratemaking purposes on utility investment in nonregulated enterprises. The NYPSC measured the royalty by applying a percentage to the total capitalization of the nonregulated operations.

In finding the royalty imputation, the NYPSC stated

> The evidence demonstrates, for example, that a utility's name and reputation have value, and that Rochester's subsidiaries were the intended beneficiaries of the use of that name and reputation. This conclusion does not depend on any showing with respect to the subsidiaries' profitability; and any other conclusion would be contrary to the evidence as well as counter-intuitive. Some adjustment is needed to recognize the free transfer from the utility to its affiliate of such intangible assets...Rochester at p. 441.

The New York commission found a value to good will, though it had not been included as a discrete item or in rate base.

> Because ratepayers have funded the salaries, training, advertising, and other activities that generate good will, they are entitled to rate recognition of revenues received by the utility in exchange for the use of that asset by an affiliate or otherwise. Where the asset is used and no revenues are received in exchange, an imputation may well be warranted.
>
> That goodwill does not appear as a discrete item has no bearing on this jurisdictional issue, for it is none the less a utility asset funded by rates, and the courts have long sustained our authority to recognize in rates revenues from the sale or lease of utility assets. Rochester at p. 431.

The NYPSC found that its authority for imputing good will value derived from its statutory charge to set just and reasonable rates. The New York commission also found that its statutory authority to approve a utility's diversification implied the authority to condition the approval on steps that would protect the ratepayers' interests.

3. Commission Analysis

Having examined the trends toward utility diversification and competition, and the treatment of good will in other jurisdictions, the Commission will turn to an analysis of the good will issues in this proceeding.

a. Logic and Record Point to Value in Good Will

In the Minnegasco case, both logic and the record indicate that a value flows to the nonregulated entity from Minnegasco's conduct of its regulated utility business. Minnegasco's long history of service and its widespread service coverage have made it "the gas company" in the minds of the public. This fact is intangible, it is not in rate base, but it logically exists and it logically has value.

It is also logical that ratepayers have supported the business which has created the value. This situation creates for ratepayers an "equitable interest" in the value of the good will. Quoting the administrative law judge's opinion, the commission in the Rochester case said:

> ...[the administrative law judge] held that while ratepayers had no right of ownership in a utility's assets, they nonetheless had an "equitable interest" in those assets. More specifically, [the administrative law judge] stated that "while ratepayers may have no right of ownership in utility assets, they clearly have a legitimate interest in seeing that those assets are used to maximize benefits to them, and it can be inferred that the Commission has the authority to assure that ratepayers are compensated for the non-utility use of such assets, if no substantive barrier exists. Rochester at p. 424.

The record in this case also supports a finding of value in Minnegasco's name and good will. The East Metro Brand Marketing Test shows that Minnegasco's name can draw three times the customer inquiries to a new nonregulated venture than can an unrelated name. It is clear that the Minnegasco name brings value to the nonregulated entity.

b. Recognition of Value

Once the fact is established that there is value in the utility's name and good will, the Commission's duty of determining just and reasonable rates requires recognition of the value. The need to recognize a value which has previously gone unrecognized is not in conflict with the Commission's finding that the Company's cost allocation methods are appropriate. No allocation system between regulated and nonregulated entities is perfect. Further, the recognition of a value for name or good will is the establishment of value for a long-term benefit much like an asset more than the allocation of a cost.

c. Commission Authority

The Commission finds that it has authority to determine that value in a utility's name and good will exists. The authority arises from the Commission's duty to set just and reasonable rates under Minn. Stat. §§ 216B.03 and 216B.08. If an asset has been transferred from a regulated utility to another entity without proper compensation to the utility, the compensation shortfall will result in rates which are not just and reasonable.

The Commission's inherent ratemaking authority to impute utility revenue was recognized in In the Matter of the Application of Northwestern Bell Telephone Company, 367 NW 2d 655 (Minn. App. 1985). In that case Northwestern Bell had sought rate case review of its transfer of directory publication operations to its affiliate, U.S. West Direct. Although U.S. West Direct paid publishing and transition fees to Northwestern Bell, the ALJ found substantial evidence that further revenue should be imputed to Northwestern Bell from its contract with its affiliate. Although the Commission did not at that time have specific regulatory authority over telephone companies' affiliated transactions, the reviewing court found that the Commission could impute revenue to Northwestern Bell if it found that the affiliated contract was not in the best interests of ratepayers. The court cited the Commission's authority to calculate just and reasonable rates.

The Commission's authority to find value in good will can also be found in the Commission's supervision over affiliated interests in Minn. Stat. § 216B.48. Subdivision 6 of that statute provides

> The Commission shall have continuing supervisory control over the terms and conditions of the contracts and arrangements as are herein described so far as necessary to protect and promote the public interest.

The public interest requires that a regulated entity be properly compensated for value that has flowed to an affiliated interest. The Commission therefore has authority under the affiliated interest statute to impute revenue for value which has passed from the utility to its affiliated interest.

d. Finding

Upon full examination of the record and consideration of the parties' arguments, the Commission finds that there is value to Minnegasco's good will as used by its nonregulated appliance sales and service affiliate. The record before the Commission in this proceeding is sufficient to determine that value exists. The Commission agrees with Minnegasco, however, that the actual quantification of the value should be determined as part of Minnegasco's current rate case proceeding, Docket No. G-008/GR-93-1090. This ongoing contested case proceeding will be the best forum to develop a full record sufficient to determine the actual level of value.

In determining the proper measure of value, the Commission will consider as one alternative a percentage of the nonregulated entity's revenues. The Commission therefore directs rate case participants to address this valuation alternative. This directive does not mean that the Commission has made any decision regarding value or methodologies at this time.

VII. CONCLUSION

In its November 10, 1992 Order, the Commission found that the return on equity issue raised by MAC was moot. The Commission directed that costs of conducting carbon monoxide checks should be allocated to the nonregulated entity. The Commission found that there was no preferential treatment in scheduling practices and that the nonregulated entity does not jeopardize system safety. The Commission dismissed allegations of inappropriate "red-tagging" and consumer fraud.

In this Order the Commission approved the Company's overall cost allocation methodologies and its winter leak survey plan with modifications. The Commission directed parties to meet and submit a report regarding the possibility of further simplifications and improvements for the Company's CAM. The Commission found that value exists in the Company's good will as used by its nonregulated appliance sales and service entity. The determination of the actual value was deferred to the ongoing rate case proceedings. In this Order, as in the November 10, 1992 Order, the Commission found that structural separation of the regulated and nonregulated entities was not necessary.

The Commission finds that the issues raised by MAC in this complaint proceeding have been resolved. Upon receipt of a satisfactory report from the work group on accounting (see Section V above) the Commission will close the complaint docket.

<u>ORDER</u>

1. On or before October 1, 1994, a work group consisting of representatives of Minnegasco, the Department and Commission Staff shall submit a report on the Company's accounting, cost allocations and reporting requirements.

2. Within 30 days of the date of this Order, Minnegasco shall submit a filing explaining how it plans to change its treatment of exception time, or in the alternative, shall clarify the necessity of reporting exception time and its treatment in the Company's CAM.

3. Within 30 days of the date of this Order, Minnegasco shall submit proposed revisions to its CAM which reflect the provisions of this Order.

4. Within 30 days of the date of this Order, Minnegasco shall comply with and explain each ALJ recommendation regarding cost allocations mentioned in the ALJ's report at Attachment A but not specifically covered in the body of this Order. The explanation shall identify each cost or cost pool and how it is apportioned.

5. On or before May 31 of each year beginning in 1994 and ending in 1996 or with the Company's next filed rate case, whichever occurs first, Minnegasco shall file a summary report on winter residential leak surveys as recommended by the Department.

6. Gas leak survey checks eligible for rate recovery under the WRLS will be limited to non-repeat checks, at a maximum of 20% of the service lines in a given community per year.

7. The valuation of Minnegasco's good will is deferred to the Company's ongoing rate case

proceeding, G-008/GR-93-1090. Parties shall address as one alternative valuation method the expression of the value as a percentage of the nonregulated entity's revenues.

8. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)